

Message Text

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ACTION NEA-10

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FM AMEMBASSY ABU DHABI

TO SECSTATE WASHDC 6326

C O N F I D E N T I A L ABU DHABI 1982

E.O. 11652: GDS

TAGS: EFIN, TC

SUBJ: COMMENT ON UAE BANKING SECTOR MANAGEMENT

REF: (A) AD 1783, (B) AD 1796

1. SUMMARY: PERSISTENCE OF UAE BANKING SECTOR PROBLEM IS CREATING CLIMATE IN WHICH SUITABILITY OF PRESENT MONETARY MANAGEMENT INSTITUTION IS LIKELY TO BE RAISED. IF ASKED, EMBASSY WISHES TO SUGGEST CONSIDERATION OF RECOURSE TO US EXPERIENCE WITH DECENTRALIZED CENTRAL BANKING SYSTEM AND DUAL - NATIONAL AND LOCAL - BANKING SYSTEM. NO ONE IN UAEG HAS THUS FAR POPPED THE QUESTION.'- END SUMMARY.

2. UAE BANKING SECTOR IMBROGLIO CONTINUES: HOWEVER, A BENEFICIAL RESULT OF LONG-LIVED CRISIS MAY BE A RE-THINKING BY ABU DHABIAN POLITICAL ELITE (WHO CONTROL FEDERAL DECISION MAKING) OF SUITABILITY OF FITTING OF MONETARY INSTITUTION WITH ECONOMIC AND POLICIAL FACTS OF LIFE. DEMON THEORIES (FEATURING FORMER CURRENCY BOARD MANAGER SCOTT), LAX REGULATION, NORTHERN EMIRATE PAROCHIALISM AND GENERALIZED GREED HAVE BEEN THOUGHT TO BE MAIN COMPONENTS OF CURRENT FINANCIAL PROBLEM. AS CRISIS DRAGS ON,
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HOWEVER, VIEW SEEMS TO BE GAINING GROUND THAT THERE ARE NO PAT ANSWERS AND THAT TECHNICAL SOLUTIONS OF BETTER PERSONNEL (THEY HAVE ASKED IMF TO RECRUIT NEW STAFF) AND THIGHER SUPERVISION, WHILE NECESSARY, ARE NOT SUFFICIENT.

3. IN OUR VIEW, BANKING SECTOR CRISIS IS SYMPTOMATIC

OF DIFFICULT IN HANDLING OVERHEATED ECONOMY/AND
STRUCTURAL INADEQUACY OF LOCAL INSTITUTION --
CURRENCY BOARD -- CHARGED WITH MANAGING ECONOMY.
GENERAL PROBLEM IN SIMPLY CONTINUAL ADAPTATION
NECESSARY TO KEEP PACE WITH SUPERCHARGED BOOM. UAE
ECONOMY HAS BEEN CHARACTERIZED BY RAMPANT INFLATION,
(LOWEST ESTIMATED COST-OF-LIVING INCREASE IS MORE
THAN 30 PERCENT ANNUALLY), DOUBLING OF IMPORTS FROM \$1.7
BILLION TO \$3.5 BILLION IN 1976 AND MAD SCRAMBLE TO
PROFIT FROM PROPERTY SPECULATION.

4. WHILE INVISIBLE HAND OF MARKET BRINGS A NOMINAL
RATIONALITY TO BUSINESS ENDEAVORS IN EMIRATES,
THE FRENETIC PACE OF ACTIVITY DOES REQUIRE SOME ORDERLY
GOVERNMENT MANAGEMENT. ENGINE OF DEVELOPMENT IN THE UAE
HAS BEEN FREE-WHEELING CREDIT
CREATION BY LOCAL BANKS, AMOUNTING TO MORE THAN 85 PERCENT
IN 1976. YET, PLANS TO BRING BANKING SECTOR ACTIVITY
INTO MORE INTEGRATED GOVERNMENT POLICY RUN HEAD-ON
INTO CURRENCY BOARD INCAPACITY TO CARRY OUT UNIFIED
MONETARY POLICY MANAGEMENT.

5. WE BELIEVE THAT PART OF THE MATTER LIES IN STRUCTURAL
MISFIT. BANKING HIERARCHY IN CURRENCY BOARD COMING FROM
A STRONG CENTRAL BANK TRADITION (BANK OF ENGLAND)
OPERATING IN A UNITARY STATE HAS BEEN UNPREDICTABLE AND
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NOT CONFIDENCE-INSPIRING IN ITS OSCILLATORY ATTEMPTS
TO CONTROL MONETARY AFFAIRS IN A HIGHLY DECENTRALIZED
POLITICAL AND ECONOMICAL ENVIRONMENT. DIFFERENCES IN
GOALS AND ABILITY TO MUSTER RESOURCES AMONG EMIRATES
ARE SUBSTANTIAL AND AFFECT OPTIMAL BANKING PRACTICES
WITHIN DIFFERENT EMIRATES. NEVERTHELESS, LOCALS TEND TO
ACCEPT ONLY BRITISH DEFINITION OF CENTRAL BANK. HOWEVER,
FACT IS THAT UAE IS A FEDERATION FUNCTIONING WITH A
PROVISIONAL FEDERAL CONSTITUTION MORE ANALOGOUS TO THE
US UNDER ARTICLES OF CONFEDERATION THAN A UNITARY STATE,
SUCH AS UK. INDIVIDUAL EMIRATE SOVEREIGNTY NOT CEDED
TO FEDERAL AUTHORITY IS ZEALOUSLY GUARDED, ESPECIALLY
BY DUBAI AND RAS AL KHAIMAH. FOR EXAMPLE, THEY HAVE
BEEN ABLE TO TORPEDO BOTH CURRENCY BOARD PLANS AND IMF'S RECENT
RECOMMENDATIONS FOR MOVEMENT TOWARDS A CENTRAL BANK. THUS
ANY PROPOSED SOLUTION NOT TAKING ADEQUATE ACCOUNT OF THE
REALITY OF DISPARATE EMIRATE POWER, CAPABILITIES AND DREAMS
CONTAINS WITHIN ITSELF SEEDS OF ITS OWN DESTRUCTION.

6. LAMENTING ABSENCE OF STRONG CENTRAL GOVERNMENT ROLE
IN FINANCIAL AFFAIRS IS USELESS AT PRESENT. WE BELIEVE
THE MORE CONSTRUCTIVE ROLE IN US POLICY OF LONG RUN

STRENGTHENING OF FEDERATION WILL BE TO POINT OUT, IF
ASKED BY UAEG, THAT THEIR CURRENT BANKING SITUATION
CAN BE READILY RESTRUCTURED IN TERMS OF INSTITUTIONS
AND POLICIES GEARED TO WORK WELL IN A FEDERAL SYSTEM. WE
WOULD BE WILLING TO INDICATE THAT A CENTRAL BANKING
SYSTEM - RATHER THAN A CENTRAL BANK - AND A DUAL
BANKING SYSTEM - OFFERING BANKS A CHOICE BETWEEN LOCAL
AND NATIONAL LEVEL REGULATION - MAY BE PARTICULARLY
APPROPRIATE, GIVEN THE EMIRATES' CURRENT STATE OF WIDELY
DIFFERING ECONOMIC RESOURCES AND ASPIRATIONS.

7. SINCE FUTURE OF CURRENCY BOARD IS NUMBER ONE TOPIC
OF CONVERSATION AMONG POLITICAL AMTORS AND OBSERVERS IN UAE,
WE HAVE DISCREETLY AND INDIRECTLY DRAWN ATTENTION TO ANALOGOUS
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HISTORICAL SITUATION BETWEEN US AND UAE AND POSSIBLE SIMILARITY
IN SOLUTIONS. THESE OBSERVATIONS HAVE BEEN RECEIVED WITH IN-
TEREST BUT THERE HAS BEEN NO EXPRESSION THUS FAR OF DESIRE
FOR ADVISORY ASSISTANCE.

8. THIS CABLE IS SENT TO WASHINGTON TO ACQUAINT CONCERNED
PARTIES OF CURRENT STATE OF PLAY. FOREIGN MINISTER
SUWAIDI, WHO IS ALSO VICE CHAIRMAN OF CURRENCY BOARD
AND CONSIDERED TO BE KEY MAN IN PRESENT SITUATION, HAS
INDICATED DESIRE TO TALK TO THE AMBASSADOR IN NEAR FUTURE
BUT WITHOUT SPECIFYING REASON. WHILE PURPOSE MAY BE FOR
ANOTHER GENERAL REVIEW OF MIDDLE EAST SITUATION, POSSI-
BILITY DOES EXIST THAT HE WILL WANT TO SOUND OUT EMBASSY
ON ITS APPRAISAL OF PRESENT BANKING SITUATION AND
POSSIBLE FUTURE EVOLUTION.
DICKMAN

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